Statement of

Jack F. Weber

President

Home Insurance Federation of America

before the

Senate Committee on Commerce, Science and Transportation

April 13, 2000

I would like to thank the Chairman and other members of the Senate Commerce Committee for this opportunity to appear before you to discuss S. 1361, the Natural Disaster Protection and Insurance Act.

This is a good bill, Mr. Chairman, and one that is worthy of the Committee's support.

Natural disasters have received a tremendous amount of attention from the Congress in the last few years. Two weeks ago, Congress debated a supplemental appropriation bill containing funds to assist the North Carolina victims of Hurricane Floyd. Exactly one year ago, Congress approved nearly $1 billion in aid to Nicaragua and Honduras to help in the clean-up of Hurricane Mitch. What makes the Mitch aid so remarkable is that the money was appropriated even though the victims were not our citizens, never paid U.S. taxes and will never repay the money.

Americans are compassionate. After a decade in which the Congress has appropriated more than $50 billion in disaster aid, there cannot be any doubt that whenever nature strikes, Congress will ride to the rescue.

The question before this Committee, however, which has been raised so eloquently by Senator Stevens and Senator Inouye, is whether this is the *best* way of dealing with natural disasters. Is it best to ask all Americans to cover the costs of the next big event, regardless of where they live? Or is it more just to assure that a properly functioning private insurance system covers the bulk of the losses?

Today, the private homeowners insurance marketplace is on shaky ground in the very places it is most urgently needed. The availability, quality, affordability and permanence of coverage is in doubt. In North Carolina, for example, a residual pool for homeowners who cannot obtain traditional insurance covers an area of 18 counties which stretch as far as 100 miles inland from the coastline. In Louisiana, a similar pool has grown more than 800 % in nine years. According to A.M. Best, the insurance rating agency which published its findings last month, the Florida insurance market is ill-prepared for the next major storm and will suffer a great number of insurance company failures. In California, Washington state and the New Madrid regions of Missouri and Tennesee, earthquake deductibles have been raised to as high as 20%, which means the average homeowner will have to absorb $20,000 … $30,000 … or even $50,000 in earthquake damage before making an insurance claim. As a result, the percentage of homeowners purchasing earthquake coverage has dropped precipitously to their lowest levels in a generation.

Ask residents in any of the regions I have just highlighted and they can tell you about the problems. But you will not find these people in a caravan ready to block entrances to the U.S. Capitol. This is not that kind of crisis. No one ever complains about the lack of insurance before they need it. It is only after the disaster that the magnitude of the problem sets in. Then, homeowners will be wondering why their policy is inadequate, why their policy doesn't cover the loss at all, or why their insurance company failed. They will ask, quite rightly, why the system failed them. They will demand relief and history shows they will get it from this Congress or the next Congress, just as they will get it from this Administration or from *any* Administration.

S. 1361 is an alternative to the above-referenced scenario. The Stevens bill, which is co-sponsored in this Committee by Senators Inouye, Breaux, Lott and Frist, stands for the premise that it is more desirable to fix the problems in the homeowners insurance market now, rather than after the next mega-catastrophe and then relying more heavily on supplemental appropriations to fix the mess.

We live in a time when the increasing frequency and severity of natural disasters is a near certainty. Just last year, the Southeast underwent the largest evacuation in history in advance of Hurricane *Floyd*. The storm lost most of its strength before making landfall sparing billions of dollars in property and perhaps thousands of lives even while bringing enormous suffering to North Carolina, South Carolina, and southern Virginia.

It was not *Floyd*, but what *Floyd* could have been, that prompted *USA Today* to editorialize in its September 17th edition that the United States remains dangerously exposed.  According to *USA Today*, "… should a 'big one' arrive – as a hurricane on the East Coast or a massive earthquake out West or in the middle states … insurer[s} are almost certain to find themselves unable to make good on all claims, leaving homeowners in the lurch and taxpayers on the hook."

The only way to address such a debacle, according to *USA Today*, is with a national <u>reinsurance</u> program.

We agree.  And we are not alone.

Both Treasury Secretary Lawrence Summers and Deputy Treasury Secretary Stuart Eizenstat have testified favorably before the House Banking Committee.  According to Deputy Secretary Eizenstat "the Administration remains convinced that a well-designed reinsurance program … could help provide the foundation for communities, individuals and the private insurance markets on which they depend to make a sound recovery in financial terms."

Moreover, the General Accounting Office, in a report issued last month, concluded that the U.S. property insurance market "continues to be vulnerable to natural catastrophe losses, despite efforts to contain potential losses since the 1990s."  Indeed, while the GAO found that the industry's ability to pay the claims of a 1-in-100 year disaster was likely, the ability to handle something greater than a 1-in-100 year event or a closely spaced series of smaller disasters could lead to a large number of insolvencies and reduce the availability of insurance in catastrophe-prone areas.

It is these events *larger* than 1-in-100 years that S. 1361 seeks to address, by providing a level of reinsurance protection which is neither available or affordable in the private marketplace. Without it, insurers will continue to reduce their exposures in the areas where consumers need it most which means inadequate coverage or no coverage for homeowners or coverage which is in doubt in the wake of insurer insolvencies.

Perhaps this is why, during the debate in the House Banking Committee, federal reinsurance legislation was supported by groups as diverse as the National Association of Realtors, the Western League of Savings Institutions, the National Association of Homebuilders, Fannie Mae, Freddie Mac and the Independent Insurance Agents of America.

Everyone loses if the homeowners insurance market fails including consumers, lenders, stockholders, local and state governments and ultimately U.S. taxpayers.

S. 1361 includes important provisions to make certain that private insurance markets and private capital are used to their fullest capacity. As I mentioned, the bill limits reinsurance coverage from the Natural Disaster Insurance Corporation to events that are greater than a 1-in-100-year event. As the term implies, these events are extremely infrequent. A 1-in-100 year event in

Florida, for example, would cause insured losses in excess of $20 billion. Under the Stevens bill, none of these losses would be covered by the national reinsurance program. Only losses greater than $20 billion would be eligible for coverage, and then at a reimbursement rate of only 50%, leaving plenty of room for private capital and reinsurance markets to provide their own capacity.

It is clear that there is a scarcity of private reinsurance to cover worst-case disasters. This "capacity gap" can best be described as an affordability problem. In simplest terms, the cost of capital – which governs the price of private reinsurance – is considerably higher than the premiums that can be collected from homeowners based on the actuarial probability of loss. As a result, there is a limit to how much reinsurance primary insurers can realistically purchase.

S. 1361 helps to close this reinsurance gap, which in turn should assure a steady and predictable supply of insurance coverage for the homeowner. While the precise threshold for this reinsurance would vary by region of the country based on population and risk, the same 1-in-100 year principle would apply, thereby assuring that all regions and all states within a region were treated equitably.

Today, the fear of a mega-castastrophe and the inability of insurance companies to adequately reinsure their exposures are forcing insurers to either withdraw from catastrophe-prone markets, reduce coverage or place a moratorium on new underwriting. S. 1361 can reverse this trend and do so in a way that is fiscally responsible. It is highly likely that the program will never require any infusion of federal revenues, since the probability of a claim is so small. But this high-level reinsurance eliminates the possibility of the super-event that poses the risk, however slight, of a financial meltdown. Only government can provide this assurance.

Private homeowners insurance, paid for by the people who live in harm's way, reduces the burden on taxpayers after a disaster and imposes costs on the homeowner which fairly reflect the risk of living in certain areas. It is in the public interest that the supply of this coverage is stable, predictable and efficiently priced. H.R. 21 will go a long way to assuring such stability and deserves your support. We look forward to working with members of the Commerce Committee as S. 1361 proceeds to mark-up.

Thank you.

Jack Weber
President
Home Insurance Federation of America
703-736-0994